

Internal Revenue Service

memorandum

CC:TL-N-2405-90

Br4:VAMoore

date: **FEB 07 1990**

to: District Counsel, Atlanta SE:ATL

Attn: Willard N. Timm, Jr.

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: Request for Tax Litigation Advice
[REDACTED]

Docket No. [REDACTED]

This responds to your memorandum dated January 3, 1990, requesting tax litigation advice regarding the revocation of the above named organization's tax exemption under I.R.C. § 501(c)(3). The organization (hereinafter "[REDACTED]") filed a petition for declaratory judgment in the Tax Court on [REDACTED] contesting the revocation under the provisions of I.R.C. § 7428(b).

ISSUES

Should the Service's revocation of [REDACTED]'s I.R.C. § 501(c)(3) status be defended in Tax Court in view of the language of the [REDACTED] adverse determination letter and the facts in the administrative file.

CONCLUSION

Generally, an organization that conducts bingo games as its primary activity can be exempt if it uses the proceeds to support a charitable program commensurate in scope with its resources. It appears that the final adverse ruling letter in this case was sent without a complete understanding of [REDACTED]'s activities during the years in question. The facts in the administrative file indicate that [REDACTED]'s bingo proceeds during [REDACTED] and [REDACTED] were used to help defray the costs of its charitable program of providing home health care services. Therefore, there are distinct litigating hazards in this case. Under the circumstances, we think it is in the government's best interest that a compromise be reached on a reasonable basis with [REDACTED]. A reasonable basis in our view would include revocation for the years [REDACTED] and [REDACTED] in return for prospective recognition from [REDACTED].

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DISCUSSION

Your request for tax litigation advice states that you believe that the issue of whether there is any charitable motivation for [REDACTED]'s bingo operation is encompassed within the quoted language of the final adverse determination, and that, if such language is sufficient to prevent the shifting of the burden of proof, the Service will prevail, given the facts in the administrative record.

The final adverse determination letter to [REDACTED] dated [REDACTED] based on an examination of [REDACTED]'s [REDACTED] and [REDACTED] tax years, stated the following:

Concurrent with the transfer of portion of your assets and liabilities to [REDACTED] on [REDACTED] your primary activity changed from that of a health care provider to a bingo game operator. The operation of bingo games is not an activity which qualifies an organization for continued recognition of exemption under section 501(c)(3). Your exemption is revoked effective [REDACTED].

[REDACTED], in its petition, alleges that it did not cease to be primarily engaged in carrying out its tax exempt, charitable health care purposes on [REDACTED]¹ [REDACTED]'s Secretary, [REDACTED], in an Affidavit dated [REDACTED] (Prop. Admin. Rec. Ex. [REDACTED]) stated, "At no time did the corporation intend to liquidate, terminate or cease doing business as a tax-exempt organization." In addition, the Report of Examination of [REDACTED]'s [REDACTED] and [REDACTED] tax years, dated [REDACTED] (Prop. Admin. Rec. Ex. [REDACTED]) states, "A portion of the proceeds from the bar and bingo games is used to defray the cost of providing home nursing services for patients not entitled to State or Federal assistance."

We have reviewed the administrative record in detail. Substantial confusion appears to have arisen as to [REDACTED]'s activities subsequent to [REDACTED]. It appears from the facts in the administrative file that [REDACTED] only ceased its operations as a Medicare Home Health Agency as of the close of business on [REDACTED], transferring its Medicare license, and its assets and liabilities thereunder, to [REDACTED].

¹ [REDACTED] also alleges that its bingo operation meets the requirements of I.R.C. § 513(f), but this does not establish [REDACTED]'s qualification for exemption, as it only supports an argument that the proceeds are not taxable as unrelated business income under I.R.C. § 511. [REDACTED] also argues that it is improperly classified as a private foundation. The court lacks jurisdiction under I.R.C. § 7428 to determine [REDACTED]'s private foundation classification. I.R.C. § 7428 is effective only with respect to determinations made after January 1, 1976. P.L. 94-455, § 1306(c). Further, once an organization is classified as a private foundation, such status continues until it is properly terminated pursuant to the provisions of I.R.C. § 507, which [REDACTED] has not done.

██████████ It appears that ██████'s primary activity after that time was to provide home health care services to persons who did not qualify for Medicare. Further, it appears that ██████'s net proceeds from its bingo operations were used to help defray the costs of providing those services on a sliding scale.² ██████ apparently ceased its bingo activities after the years in question.

Rev. Rul. 64-182, 1964-1 C.B. 186, provides that an organization is exempt that uses its income from the rental of space in a commercial office building to make contributions to other charitable organizations, where it is shown to be carrying on through such contributions a charitable program commensurate in scope with its financial resources. Thus, an organization can qualify for exemption under I.R.C. § 501(c)(3) notwithstanding that it conducts otherwise commercial activities if it establishes that it devotes the proceeds from such activities to a charitable program commensurate in scope with its financial resources and it avoids the proscription of I.R.C. § 502. See Piety, Inc. v. Commissioner, 82 T.C. 193 (1984) (organization's sole activity was bingo, and exemption was denied under section 502).

You cite Make a Joyful Noise, Inc. v. Commissioner, T.C. Memo 1989-4, in support of the revocation of ██████'s exemption. The organization in that case ("MJN") stated in its application for exemption that it would conduct bingo games at two sites and use the proceeds to purchase a camp for disadvantaged children and the elderly and to make contributions to other section 501(c)(3) organizations. The Tax Court found significant the fact that MJN had made "almost imperceptible" progress toward achieving its stated charitable goals of operating a camp for disadvantaged youth or elderly citizens. ██████'s operations are distinguishable from those of MJN on the grounds that ██████'s primary activity was not conducting bingo, it actually conducted substantial charitable activities, and its net proceeds from bingo were devoted to its charitable program.

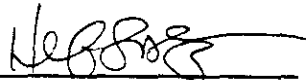
We think that the facts in the administrative file do not clearly support the conclusion that ██████'s primary activity during the years in question was the operation of bingo games. Further, even assuming, arguendo, that its primary activity was the operation of bingo games, this fact alone does not support a revocation of ██████'s exemption if ██████ can establish that it conducted the bingo games in furtherance of

² The Report of Examination does not accurately reflect the percentage of ██████'s income from its bingo operation that was used for the support of its exempt function. In order to determine such percentage, the calculation should include not only amounts paid to nurses, but also an allocable amount of Administrative & Overhead. Since it is not known how much of Administrative & Overhead expenses to allocate to exempt functions, such percentage cannot be accurately calculated.

its charitable program of providing home health care. Therefore, we see significant litigating hazards in this case, and we strongly recommend that settlement negotiations be pursued. [REDACTED] may be willing to accept revocation of its exempt status for the years in question, [REDACTED] and [REDACTED], as [REDACTED] does not appear to have had net profits in those years, in return for prospective recognition of exemption from [REDACTED] when it no longer conducted bingo operations. It will be necessary to coordinate any such settlement with Exempt Organizations personnel in the key district office. If for any reason settlement is not possible, please communicate with us so that we may further consider the matter.

If you have any questions in this regard, call V. Moore at FTS 566-3305.

MARLENE GROSS
Assistant Chief Counsel
(Tax Litigation)

By: 
HENRY G. SALAMY
Chief, Branch No. 4
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Attachments:
Administrative files (2)